



**COMMODITY OPTIONS AND  
AGRICULTURAL SWAPS  
RIN 3038-AD21**

April 4, 2011

David Stawick, Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, D.C. 20581

**Re: Comments on Notice of Proposed Rulemaking on Commodity Options and Agricultural Swaps, under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”) (17 CFR Parts 3, 32, 33 and 35)**

Dear Mr. Stawick:

The trade associations comprising the “Not-For-Profit Electric End User Coalition” (the “Coalition”)<sup>1</sup> respectfully submit these comments to the Commodity Futures Trading Commission (the “Commission”) on the **Notice of Proposed Rulemaking on Commodity Options and Agricultural Swaps** (76 Fed. Reg. 6095, Feb. 3, 2011, the “Commodity Options NOPR”).

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<sup>1</sup> The National Rural Electric Cooperative Association, the American Public Power Association and the Large Public Power Council (see Section I for a description of the members of each such trade association). The comments contained in this filing represent the comments and recommendations of the organizations comprising the “Coalition,” but not necessarily the views of any particular member with respect to any issue.

We have no comments on the provisions in the Commodity Options NOPR with respect to agricultural swaps. Nor do we comment on how the provisions in the Commodity Options NOPR might affect options on agricultural commodities or options on exempt commodities other than energy and energy-related commodities. We note that the Commodity Options NOPR provides an overview and summary of the comments received by the Commission on the Commission's Advanced Notice of Proposed Rulemaking regarding the agricultural swaps provisions in the Act. However, the Commodity Options NOPR provides no such summary or response to the comments on the Commission's "Definitions ANOPR," which included numerous comments on the provisions of the Act which would affect commodity options outside the agricultural commodity asset class.<sup>2</sup> We respectfully request that the Commission provide a prompt and thorough analysis of, and a response to, the public comments on the provisions of the Act affecting commodity options.

Our comments on the Commission's rulemakings to date have focused on the aspects of the Proposed Rules that would require an "end user"<sup>3</sup> of non-cleared "swaps,"<sup>4</sup> of a type that the

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<sup>2</sup> We direct the Commission to the comment letter submitted by the Not-For-Profit Energy End User Coalition dated September 20, 2010, submitted in response to the Commission's August 2010 "Definitions ANOPR," (the "Definitions ANOPR Comment Letter") and, in particular, to the comments in Section II (which concurs with Section II of the comments of the Edison Electric Institute in the same docket) on importance of commercial energy and energy-related commodity options to the NFP Energy End Users. A web link to the Definitions ANOPR Comment Letter is available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26217&SearchText>.

<sup>3</sup> This term is not defined in the Act, but is used to describe an entity that is not a "financial entity" (so we use the term "non-financial entity"), that utilizes "swaps" (see footnote 4) to hedge or mitigate commercial risk, and that notifies the Commission how it generally meets its financial obligations associated with entering into non-cleared swaps. CEA 2(h)(7)(A). Such a non-financial entity may except a swap to which it is a party from the clearing requirements of the Commodity Exchange Act, as amended by the Act (the "CEA") pursuant to what is called the "end-user exception." NFP Electric End Users are non-financial entities, and the NFP Electric End Users anticipate utilizing the end-user exception in respect of all Energy Commodity Swaps to which they are parties.

<sup>4</sup> We have footnoted this term, and we direct the Commission to our comments on the definition of "swap" in the Definitions ANOPR Comment Letter, the web link for which is found at footnote 2. In NFP Electric End Users comment letters since September 2010, we have reserved our right to change or expand our comments in light of the Commission's final rules in respect of that definition, which serves as a foundation for the Commission's expanded jurisdiction under the Act. Without that definition, the sequencing of the Commission's Proposed Rules has precluded the NFP Electric End Users and other market participants from being able to assess the effect, costs and benefits of the Proposed Rules implementing the Act on

NFP Electric End User Coalition defines as “Energy Commodity Swaps,”<sup>5</sup> to register and comply with the Commission’s new regulatory requirements. Beginning in September of 2010 with our comment letter on the Commission’s “Definitions ANOPR,”<sup>6</sup> we have consistently asked the Commission to clarify that many commercial energy and energy-related transactions, ***including commercial options on such nonfinancial commodities***, do not fall within the scope of the defined term “swap.” In these comments, we respectfully once again make that request. It remains essential to the NFP Electric End Users’ ability to manage their commercial risks that the Commission confirm the ongoing applicability of this important exemption for commodity options. Such a further definition clarification or exemption is not precluded by the Act, and such a regulation is consistent with both Commission precedent and Congressional intent.

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their commercial activities. The Commission has proposed more than 40 rules for comment without defining this most fundamental term. The NFP Electric End Users respectfully request the Commission to further define the term “swap” to exclude or exempt the types of commercial energy and energy-related transactions in which the NFP Electric End Users engage every day, including forward transactions in nonfinancial commodities which by their terms settle physically, ***commercial (or “trade”) options on nonfinancial commodities***, capacity, transmission and transportation services contracts and emissions and renewable energy contracts. We use the term “non-cleared” in this comment letter, rather than “uncleared,” so that our comments to the Commission on different rulemakings on identical concepts are consistent. The Act, and the CEA as amended by the Act, use the terms interchangeably. We respectfully request that the Commission confirm in its regulations, for the sake of clarity, that the terms are synonyms.

<sup>5</sup> We use the term “Energy Commodity Swaps” to mean (a) those non-cleared swaps referencing or derived on energy commodities in which the NFP Electric End Users transact in the ordinary course of their core public service activities, such as electric energy, natural gas, and other fuels for electric generation, including coal and fuel oil (but excluding crude oil, gasoline or refined petroleum products other than fuel oil -- these commodities are not germane to the NFP Electric End Users’ public service activities, and the markets for these commodities and related derivatives are distinguishable from the markets in which the NFP Electric End Users participate), (b) those non-cleared swaps referencing or derived on transmission, transportation, generation capacity or storage concepts or services related to the energy commodities described in (a), and (c) those non-cleared swaps referencing or derived on environmental or emissions regulations, or renewable energy or other environmental attributes, applicable to the NFP Electric End Users. All of these “Energy Commodity Swaps” reference or are derived on “nonfinancial commodities,” are intrinsically related to our members’ core public service activities, and many are subject to the continuing jurisdiction of regulators other than the Commission.

<sup>6</sup> See footnote 2 for a web link for that comment letter.

The Coalition's members are commercial enterprises, not swap dealers or major swap participants, and not financial entities. Our members engage in energy and energy-related transactions (futures, options on futures, and over-the-counter ("OTC") commodity-based derivatives, including options and swaps) only to mitigate or hedge commercial risks that arise in the course of their public service activities. Our members do not speculate in energy or energy-related commodities or derivatives.<sup>7</sup> Our members do engage routinely in commercial energy and energy-related commodity and derivatives transactions, including options on these nonfinancial commodities.

Congress expressly excluded from the statutory definition of "swap" forward transactions on nonfinancial commodities that by their terms are intended to settle physically.<sup>8</sup> In doing so, Congress acknowledged that such transactions are not trading products, but commercial commodity transactions with the customized terms and conditions and credit-risk sensitive pricing terms that are not standardized or fungible enough to be appropriate for exchange-trading or clearing. There is no reason to believe that Congress intended, or would have intended, a more restrictive regulatory treatment of options on those very same nonfinancial commodities. In fact, such commodity options, if they have any value at the time the option is exercised, become such nonfinancial commodity forwards, i.e. such "non-swaps."

It is only logical to assume that Congress intended the "trade option exemption" to continue, to provide the same regulatory certainty to non-financial (or "commercial") entities engaging in nonfinancial commodity options in connection with their commercial enterprises. The NFP Electric End User Coalition respectfully requests that the Commission propose for public comment a "trade option exemption" from the definition of "swap" for options on nonfinancial commodities to preserve the benefit of this cost-effective risk management tool for non-financial entities hedging commercial risks.

As the Commission (along with the Securities and Exchange Commission and the prudential regulators) embarks on the complex and interrelated rulemakings necessary to implement the Act, the Coalition respectfully requests that the regulators keep in mind at each step along the way how its Proposed Rules, and the sequencing of their issuance, will impact the non-financial entities that are "end users" and "bona fide hedgers." This is especially important because the Proposed Rules will impact non-financial entities engaging in commercial

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<sup>7</sup> The term "speculate" as used herein means taking a position, and subsequently offsetting it with another position, for the purpose of profiting from favorable movements in market prices. Speculation is a risk-increasing activity in which commodity traders commonly engage. An NFP Electric End User may enter into an energy or energy-related derivatives transaction that settles favorably (i.e., "in the money"). But that favorably-settling energy or energy-related derivatives transaction offsets a correlated unfavorable price movement/settlement in the commercial risk being hedged.

<sup>8</sup> See CEA Section 1a(47)(B)(ii).

commodity and commodity-based derivative transactions, often without a financial entity such as a swap dealer or major swap participant to bear the burdens and costs of the types of regulatory obligations to which such financial entities are accustomed. The NFP Electric End Users are not financial entities, and they have not previously been regulated by the Commission. The NFP Electric End Users and the markets in which they participate are comprehensively regulated by other agencies at the Federal, state and local levels. On the day after the effective date of the Act, each of these non-financial entities will still have a commercial enterprise to run, commercial risks to manage and, for the NFP Electric End Users, retail energy customers to serve, in a safe, reliable and environmentally responsible manner.

The Act was intended by Congress to regulate the financial markets more effectively, to provide regulatory oversight to financial entities and to reduce risk to the financial system. It was also intended to bring more transparency to the swap markets. We fully support these policy objectives. However, the regulations must tell commercial enterprises which of their ongoing activities will now be regulated by the Commission and how to comply with the Commission's new rules. The regulations should not impose unnecessary new regulatory costs and burdens on these non-financial commercial enterprises.

## **I. THE COALITION MEMBERS**

The Coalition is comprised of three trade associations representing the interests of not-for-profit, consumer-owned electric utilities in the United States (collectively, the "NFP Electric End Users").<sup>9</sup> The primary business of these NFP Electric End Users has been for well over 75 years, and still is today, to provide reliable electric energy to their retail consumer customers every hour of the day and every season of the year, keeping costs low and supply predictable, while practicing good environmental stewardship. The NFP Electric End Users are public service entities, owned by and accountable to the American consumers they serve.

### **A. NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION ("NRECA")**

Formed in 1942, NRECA is the national service organization for more than 900 not-for-profit rural electric utilities and public power districts that provide electric energy to approximately 42 million consumers in 47 states or 12 percent of the nation's population. Kilowatt-hour sales by rural electric cooperatives account for approximately 11 percent of all electric energy sold in the United States. NRECA members generate approximately 50 percent

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<sup>9</sup> The Coalition is grateful to the following organizations and associated entities who are active in the legislative and regulatory policy arena in support of the NFP Electric End Users, and who have provided considerable assistance and support in developing these comments. The Coalition is authorized to note the involvement of these organizations and associated entities to the CFTC, and to indicate their full support of these comments and recommendations: the Transmission Access Policy Study Group (an association of transmission dependent electric utilities located in more than 30 states), ACES Power Marketing and The Energy Authority.

of the electric energy they sell and purchase the remaining 50 percent from non-NRECA members. The vast majority of NRECA members are not-for-profit, consumer-owned cooperatives which distribute electricity to consumers. NRECA's members also include approximately 66 generation and transmission ("G&T") cooperatives, which generate and transmit power to 668 of the 846 distribution cooperatives. The G&T cooperatives are owned by the distribution cooperatives they serve. Remaining distribution cooperatives receive power directly from other generation sources within the electric utility sector. Both distribution and G&T cooperatives were formed to provide reliable electric service to their owner-members at the lowest reasonable cost. All these cooperatives work together pursuant to their common public service mandate from their members, often without the type of contracts that exist between for-profit entities. Rather, many cooperatives deal with each other under take and pay "all requirements contracts" which set forth the terms of service/energy sales, but not necessarily the price for such service/energy sales. For example, as between a G&T cooperative and its distribution cooperative owner-members, the price is often determined based on a "cost of service" rate, with no market price component.

Electric cooperatives own approximately 43% of the distribution lines in the U.S., reaching some of the country's most sparsely populated areas, from Alaskan fishing villages to remote dairy farms in Vermont. In an electric cooperative, unlike most electric utilities, its owners -- called "members" of the cooperative -- are also customers, who are able to vote on policy decisions, directors and stand for election to the board of directors. Because its members are customers of the cooperative, all the costs of the cooperative are directly borne by its consumer-members.

The vast majority of NRECA's members meet the definition of "small entities" under the Small Business Regulatory Enforcement Fairness Act ("SBREFA"). 5 U.S.C. §§ 601-612 (as amended Mar. 29, 1996). Only four distribution cooperatives and approximately 28 G&Ts do not meet the definition. SBREFA incorporates by reference the definition of "small entity" adopted by the Small Business Administration (the "SBA"). The SBA's small business size regulations state that entities which provide electric services are "small entities" if their total electric output for the preceding fiscal year did not exceed 4 million megawatt hours. 13 C.F.R. §121.201, n.1.

#### B. AMERICAN PUBLIC POWER ASSOCIATION ("APPA")

APPA is the national service organization representing the interests of publicly-owned electric utilities in the United States. More than 2,000 public power systems provide over 15 percent of all kilowatt-hour sales to ultimate customers and serve 45 million people. APPA's member utilities are not-for-profit utility systems that were created by state or local governments to serve the public interest. These systems take various forms, including departments of a municipality; a utility board or a public utility district formed under state or local law; a joint action agency or joint power agency formed under state law to provide wholesale power supply and transmission service to distribution entity members; a state agency, authority or instrumentality; or other type of political subdivision of a state. Like the members of NRECA, the vast majority of APPA's members are "small entities" under SBREFA.

Public power utilities perform a variety of electric utility functions. Some generate, transmit, and sell power at wholesale and retail, while others purchase power and distribute it to retail customers, and still others perform all or a combination of these functions. All these systems work together pursuant to their common statutory and regulatory mandates. Some are “vertically integrated” electric utilities (engaging in generation, transmission, distribution and retail sales), while others are vertically integrated by contract with other “201(f) entities” (entities that are exempt from full Federal Power Act rate regulation under Section 201(f) of that statute), or by contract with third parties.

Public power utilities are accountable to elected and/or appointed officials and, ultimately, the American public. The focus of a public power utility is to provide reliable, safe electricity service, keeping costs low and predictable for its customers, while practicing good environmental stewardship.

### C. LARGE PUBLIC POWER COUNCIL (“LPPC”)

The Large Public Power Council is an organization representing 24 of the largest locally owned and operated public power systems in the nation. LPPC members own and operate over 75,000 megawatts of generation capacity and nearly 34,000 circuit miles of high voltage transmission lines. Collectively, LPPC members own nearly 90% of the transmission investment owned by non-federal public power entities in the U.S. Our member utilities supply power to some of the fastest growing urban and rural residential markets in the country. Members are located in 11 states and Puerto Rico -- and provide power to some of the largest cities in the country including Los Angeles, Seattle, Omaha, Phoenix, Sacramento, Jacksonville, San Antonio, Orlando and Austin.

Members of the LPPC are also members of APPA. LPPC members are larger in size than other APPA members due to the size and population density of the communities to which they provide power. LPPC members often require larger, more complex and more diverse types of resources to serve their communities as well, and therefore LPPC members own and operate more complex generation and transmission assets than many other APPA members. However, despite being larger in size and resources, LPPC members’ public service mission remains the same -- to provide reliable, safe electricity service, keeping costs low and predictable for its customers, while practicing good environmental stewardship.

### D. THE COALITION’S MEMBERS ARE UNIQUE, AS ARE THE “MARKETS” IN WHICH THEY TRANSACT AND THE TRANSACTIONS IN WHICH THEY ENGAGE

The NFP Electric End Users represented by the Coalition include public power utilities and rural electric cooperatives. Some are quite large, but most of these NFP Electric End Users are very small, reflecting the communities they serve, the success of those communities in providing reliable essential services for their citizens at the lowest reasonable rates and, in the case of rural electric cooperatives, the contribution to Americans’ quality of life of the Rural Electrification Act of 1936.

Some NFP Electric End Users generate, transmit and sell electric energy to their fellow public power systems and cooperatives and to third parties at wholesale. Others purchase electric energy (from associated public power systems and cooperatives or from third parties), and distribute it to retail consumers. Some NFP Electric End Users act as operating or purchasing agent on behalf of multiple co-owners of a generation project or a project entity that generates and transmits electric energy to participating public power systems. Still others perform all or a combination of these commercial functions. The Coalition's members are unique among "end users" whose transactions are potentially subject to the Commission's regulation as "swaps" (even among those who are "end users" of energy and energy-related commodities and swaps) in that the NFP Electric End Users have no stockholders and are accountable to elected and/or appointed officials, and ultimately to the consumers of their services. Similarly, the NFP Electric End Users that are electric cooperatives are directly accountable to their consumer-members and boards. Any gains or losses on an NFP Electric End User's energy transactions result in higher or lower energy costs to American businesses and consumers. The NFP Electric End Users do not seek profit for shareholders or investors. Their public service mission is the singular purpose and reason for their existence. The interconnected Federal, state and local system of laws and financial regulation within which they operate is designed specifically to support this public service mission.

The market for power in North America is comprehensively regulated at the Federal, state and local level, with a focus on reliability of service and regulated rates payable by the retail customer. In addition, the electric industry in North America (including the NFP Electric End Users) is subject to extensive environmental regulations and, in many states, renewable energy standards. Unlike other markets for OTC derivatives and/or "swaps" (as newly defined by the Act), these are not unregulated markets. They are comprehensively regulated, and any new regulatory structure must be carefully tailored so as not to conflict with existing regulatory structures.

Some of the NFP Electric End Users' energy transactions are conducted through, "on," or "in" the "markets" operated by various regional transmission organizations or independent system operators (collectively, "RTOs"). Each RTO operates its "market" in a defined geographic area of the United States, and all RTOs operate under a comprehensive regulatory structure established by the Federal Energy Regulatory Commission ("FERC"). The FERC-regulated markets are established by tariff in many instances, rather than by contract, and analogies between these FERC-created/FERC-regulated "markets," and the bilateral contract markets between independent and arm's length third parties, are inapt. Although, in some ways, the markets conducted by the various RTOs are similar in structure, no two RTO markets are exactly alike and their "products" or "transactions" are not fungible between RTOs. Each RTO also has in place credit risk mitigation policies and procedures to protect market participants from credit risk from other market participants, and to protect the RTO markets from disruption



due to a market participant default. These RTO credit risk mitigation policies are established and maintained in accordance with the principles established by FERC.<sup>10</sup>

FERC's mandate from Congress under the Federal Power Act is to regulate in the "public interest" -- which is interpreted as the delivery of reliable electric energy to American consumers at "just and reasonable" rates. It is under this regulatory mandate that the RTOs (overseen by FERC) have established, and currently maintain and operate, the FERC-regulated markets. The RTO markets are intrinsically tied to the physical transmission capacity, reliability, and ultimate delivery of electric energy in interstate commerce at just and reasonable rates.

Most of the Energy Commodity Swaps in which the NFP Electric End Users are engaged are currently conducted under exemptions or exclusions from the Commodity Exchange Act (the "CEA"), whether conducted in the bilateral OTC contract market (as most are, including RTO transactions) or on exempt commercial markets. The participants in these markets are "eligible contract participants" either by virtue of their size and financial characteristics, or by virtue of their use of underlying cash commodities relevant to their businesses (as "eligible commercial entities"). Other than a few large industrial companies, retail energy consumers generally do not participate in these markets directly. The physical and financial commodity transactions occur principal to principal, through agents and energy brokers, with a wide range of counterparties.

NFP Electric End Users engage in a substantial number of non-cleared, "end-user-to-end-user" Energy Commodity Swaps.<sup>11</sup> Counterparties for these Energy Commodity Swaps are typically the NFP Electric End Users' traditional commercial (physical energy commodity) counterparties, rather than financial entities (whether financial intermediaries or financial institutions) from whom the NFP Electric End Users secure financing. In the markets for Energy Commodity Swaps, an end user may be a buyer one day and a seller the next, as its seasonal commercial needs for one or more energy commodities fluctuate. And the end user may be a buyer of one type of energy commodity or derivative, and a seller of another type of energy commodity or derivative. In the markets for Energy Commodity Swaps, a single energy company may buy natural gas swaps and sell electric energy swaps for the same month. Or it may buy natural gas swaps for one month and sell natural gas swaps for the next month. Most energy companies' commercial risks are system-specific, geography-specific and seasonal, and

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<sup>10</sup> Such policies were recently updated by FERC in its Final Rule on Credit Reforms in Organized Wholesale Electric Markets, 18 CFR Part 35, Docket No. RM10-13-000, Order No. 741 (issued October 21, 2010).

<sup>11</sup> We use the term "end-user-to-end-user swaps," but we also intend to include in this definition swaps that are executed by two non-financial entities, whether or not one or both of the non-financial entities elects the end-user exception. There will be an even higher percentage of these end-user-to-end-user swaps if the Commission does not clarify its definition of "swap" to exclude or exempt commercial energy and energy-related commodity and derivatives transactions in which the NFP Electric End Users engage every day. See footnote 4.

risk management decisions are made based on changing long-term weather forecasts, generation or transmission availability and/or load projections. Some energy companies hedge multiple commodity risks, such as an electric utility hedging the commercial risks of its input (natural gas as fuel) and output (electric generation/deliverable electric energy). Cross-commodity hedging is also commonplace. There is no “sell-side/buy-side” dichotomy in the non-cleared Energy Commodity Swap market, and there are often no financial intermediaries -- many non-financial entities play multiple commercial end user roles.<sup>12</sup>

The transactions contain customized, non-quantitative operating conditions, transmission or transportation contingencies, and operating risk allocations that one would expect between commercial enterprises. Although legal and administrative terms are standardized through the use of master agreements, the negotiated schedules to such master agreements and individual transaction confirmations are highly negotiated and differ based on the needs and preferences of each pair of counterparties. These are commercial transactions, when viewed through the traditional lens of “goods” and “services” used by American businesses. It is only when the transactions are viewed through the financial markets lens that these transactions are described using the financial market regulatory labels such as “exempt commodities,” “swap agreements,” “swaps” or “nonfinancial commodities” -- and analogized to “futures contracts” or “positions” created or made by financial entities trading on a transaction-by-transaction basis for profit or speculation, and potentially subject to regulation traditionally applicable to such financial market transactions.

Credit risk management in the bilateral contract world of non-cleared Energy Commodity Swaps is grounded in broad-based, continuing and reciprocal commercial credit risk analysis and credit risk management between each set of counterparties, backstopped by credit support and collateralization principles. This type of credit risk management is not analogous to the transaction-by-transaction margining (without regard to counterparty identity) that takes place in today’s CFTC-regulated futures and options markets.

Today, the NFP Electric End Users have the commercial risk management choice to conduct some Energy Commodity Swap transactions on CFTC-regulated contract markets, or to clear some of these transactions through CFTC-regulated centralized clearing entities. Listed and cleared transactions are typically those delivered at “hubs,” in tradable increments and for tradable durations -- transactions or “products” that are “standardized” and “fungible” in financial market terms, and with sufficient contract trading liquidity to allow for financial markets to function. As the CFTC-regulated financial markets have evolved, some of the larger NFP Electric End Users have chosen to manage certain of their commercial risks using exchange-traded and cleared instruments. But the vast majority of NFP Electric End Users’ commercial commodity transactions and Energy Commodity Swaps are still conducted “the old

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<sup>12</sup> Please let us know if the NFP Electric End Users can provide the Commission with further information on this important and unique aspect of the markets for Energy Commodity Swaps.

fashioned way”: under tariffs within the public power and cooperative systems or by contract with known and reliable physical commodity suppliers and customers, and not with CFTC-regulated financial intermediaries or on exchanges or with clearing entities. And the vast majority of NFP Electric End Users do not either post collateral to their counterparties or require that their counterparties post collateral to them.<sup>13</sup>

Due to the Act’s wholesale deletion of applicable exemptions in the CEA, and the potentially sweeping nature of the Act’s new definitions, these everyday business transactions of the NFP Electric End Users are at some risk of being redefined as “swaps.” Congress has repeatedly indicated that its intention was NOT to reduce risk management options for end users or to impose new regulatory costs on end users hedging the risks of traditional commercial enterprises. But Congress is relying on the regulators to implement understandable rules consistent with that intent. Congress did not intend for the regulators to read the expansive language of the Act without regard to legislative intent or to regulate and impose costs on end users as if they were financial entities or professional financial market participants.<sup>14</sup>

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<sup>13</sup> For examples of the diversity of credit support and collateral (or “margin”) relationships which the NFP Electric End Users have in place with their Energy Commodity Swap counterparties, as well as the diversity of assets, load (customers served within the utility’s geographic service territory), energy hedging and risk management policies, and swap usage within the Coalition’s membership, see the profiles attached to the NFP Electric End Users’ comment letter to the Capital and Margin Task Force, dated December 14, 2010. Such comment letter can be found at the following link: [http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission5\\_121410-0017.pdf](http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission5_121410-0017.pdf). None of these profiles purport to be “typical” of large, medium or small NFP Electric End Users (by number of customers). No NFP Electric End User is typical, given their diverse commercial profiles. However, the Commission’s regulations have to work for all NFP Electric End Users who share the identical public service mission.

<sup>14</sup> The Commission should not, in its rulemaking under the Act, be distracted by those commentators who intone or invoke the names “AIG” or “Enron,” without analysis. In fact, neither AIG nor Enron would be entitled to the end-user exception under the CEA as amended by the Act, and neither would be exempt from margin requirements applicable to cleared swaps by clearing entities. AIG, whose substantial positions in non-cleared credit default swaps allegedly endangered the financial system, would be registered and regulated as a “major swap participant” in credit default swaps. Enron, with its notorious “one-to-many” electronic interface offering to buy or sell swaps from energy to broadband, is the poster child for the Act’s definition of “swap dealer,” and would be registered and regulated as such. The NFP Electric End Users, and other non-financial entities hedging commercial risk with Energy Commodity Swaps and other types of non-cleared swaps, simply do not represent the types of systemic risk that the mere mention of those entities’ names implies.

## **II. GENERAL COMMENTS**<sup>15</sup>

The NFP Electric End Users are eager to understand whether and how the energy and energy-related derivatives transactions in which they engage every day are to be regulated by the Commission under the comprehensive new regulatory structure that the Commission is establishing to implement the Act.<sup>16</sup> The foundational issue, which has concerned the NFP Electric End Users since the Act was passed, is that the Commission further define or clarify the term “swap” to exclude or exempt from the Commission’s jurisdiction the energy and energy-related derivatives transactions on which the NFP Electric End Users rely to manage the commercial risks of their public service activities.<sup>17</sup> The Coalition’s concern has always included a concern that energy and energy-related commodity options (“trade options”) continue to be excluded or exempted from the Commission’s jurisdiction. See “footnote 4” in virtually every comment letter the Coalition has filed to date. The Commodity Options NOPR, by summarily deleting the commodity trade option exemption and presuming that there will be no detrimental market consequences, seems to have rejected without acknowledgment or explanation the Coalition’s request for regulatory certainty.

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<sup>15</sup> The Coalition has reviewed the comments submitted in this docket by the Edison Electric Institute (“EEI”) and the Electric Power Supply Association (“EPSA”)(the “EEI/EPSA Letter”), and we will concur by reference to Sections of that EEI/EPSA Letter herein as appropriate, rather than restating the comments.

<sup>16</sup> The Commission’s new authority under the Act is not evolutionary, but truly revolutionary. The Act deletes the exclusions and exemptions under which the current over-the-counter energy and energy-related derivatives markets have developed. The Act makes such risk management transactions “unlawful,” unless the NFP Electric End Users and their counterparties comply with the Commission’s new rules or fit within its exemptions. Consequently, the Coalition is relying on the Commission to establish a new and integrated market regulatory structure that preserves the ability of non-financial entities to continue to hedge commercial risks, without disruption and without unnecessary new costs and burdens imposed by the Commission’s new regulatory regime. The disruption caused by elimination of the commodity trade option exemption will be more significant in the markets for energy and energy-related commodities and commodity-based derivatives than in other markets due to the higher percentage of end-user-to-end-user transactions. See Section IID for more detail on this unique aspect of these markets.

<sup>17</sup> The Coalition’s concern was first expressed in the Definitions ANOPR Comment Letter filed in September 2010, a web link to which is provided in footnote 2. The same comment has been echoed in more than 15 subsequent comment letters filed by the Coalition in the Commission’s rulemaking dockets pursuant to the Act.

A. THE COMMISSION SHOULD CONFIRM IN THE RULES THAT AN NFP ELECTRIC END USER IS AN “ELIGIBLE CONTRACT PARTICIPANT” FOR SWAPS REFERENCING OR DERIVED ON A COMMODITY IN WHICH THE NFP ELECTRIC END USER TRANSACTS IN CONNECTION WITH ITS BUSINESS

In Section IIA of the Coalition’s comment letter on the Notice of Proposed Rulemaking on Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant,” 75 Fed. Reg. 80,174 (Dec. 21, 2010), filed February 22, 2011 (the “Entity NOPR Comment Letter”),<sup>18</sup> we made the point that many of the smaller NFP Electric End Users may not meet the financial hurdles required by clauses (v) and (vii) of the definition of “eligible contract participant.”<sup>19</sup> Nonetheless, these NFP Electric End Users meet the commercial tests required to be “eligible commercial entities” under that definition in the CEA,<sup>20</sup> as they transact in Energy Commodity Swaps to hedge the underlying commodities used in the ordinary course of their public service activities. However, there are language ambiguities in the defined terms that raise a question as to whether an NFP Electric End User can qualify as an “eligible contract participant” if it does not meet the independent financial hurdles in the definition of “eligible contract participant.”

We asked in the Entity NOPR Comment Letter that the Commission confirm that the NFP Electric End Users are eligible contract participants notwithstanding their relatively smaller asset values and/or net worth.<sup>21</sup> We also asked the Commission to clarify that, for Energy Commodity Swaps to which an NFP Electric End User is a party and for which it elects the end-user exception to clearing under CEA Section 2(h)(7), the NFP Electric End User may also rely on CEA Section 2(h)(8) to except the Energy Commodity Swap from mandatory exchange-trading, notwithstanding the seemingly inconsistent provision in CEA Section 2(e) that would require the NFP Electric End User to transact Energy Commodity Swaps only on a designated contract market.

The Commodity Options NOPR now creates an even more serious issue for NFP Electric End Users who do not meet the eligible contract participant financial hurdles. The Commodity Options NOPR acknowledges that “the primary substantive change to this market will be that,

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<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27917&SearchText=wasson>

<sup>19</sup> CEA Section 1a(18)(v) and (vii).

<sup>20</sup> CEA Section 1a(17).

<sup>21</sup> For more information on this request, see the Entity NOPR comment letter, a web link for which is provided at footnote 18.

while current Section 32.4 imposes no minimum net worth requirement on participants [that purchase or sell commodity options in connection with their commercial business without compliance with the CEA], **both purchasers and sellers of commodity options under revised Section 32.4 will have to qualify as ECPs** [eligible contract participants], just as swaps (other than swaps on a DCM [designated contract market]) may only be entered into by ECPs.” NOPR at 6102. This “primary substantive change” is a serious issue for NFP Electric End Users.

The Commodity Options NOPR specifically requests comment on this issue in two places. On page 6102, the Commodity Options NOPR asks: “will the revisions [to Section 32.4] significantly affect hedging opportunities available to currently active users of the trade options markets?” On page 6104, the Commodity Options NOPR asks the same question, and adds: “is there any reason not to revise Section 32.4 as proposed?” To these questions, the NFP Electric End User Coalition respectfully, though resoundingly, answers “YES.”

If the Commission eliminates the ability of the NFP Electric End Users to engage in energy and energy-related commodity options, or conditions the use of such trade options on the NFP Electric End Users qualifying as eligible contract participants, it will have a significant and detrimental effect on the NFP Electric End Users’ ability to hedge their commercial risk in a cost effective way.

**B. NOTHING IN THE ACT REQUIRES THE COMMISSION TO ELIMINATE THE “TRADE OPTION EXEMPTION” IN PART 32.4 OF ITS RULES. DELETION OF THIS IMPORTANT EXEMPTION FOR COMMERCIAL END USERS, WITHOUT REPLACING IT WITH A SUBSTANTIALLY SIMILAR EXEMPTION OR EXCLUSION FROM THE DEFINITION OF SWAP, IS CONTRARY TO CONGRESSIONAL INTENT**

As the Commodity Options NOPR points out, the broad new statutory definition of “swap” includes commodity options in CEA Section 1a(47)(i). However, the Commission’s analysis for purposes of its rulemaking cannot stop at just reading the words of the Act, and implying that its hands are tied. The Act does not require the Commission to discard all regulatory exemptions and precedent that have built up over the course of decades under the CEA prior to the Act.<sup>22</sup> Instead, as the Commission recognizes, the Act also specifically gives

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<sup>22</sup> On March 31, 2011, in Chairman Gensler’s testimony before the House Agriculture Committee about the definition of “swap” in the Act and the exclusion for forward contracts on nonfinancial commodities, he noted that commercial market participants have relied for decades on Commission orders, interpretations and cases for regulatory certainty that these contracts were outside the Commission’s jurisdiction. This precedent is compelling regardless of the fact that an expansive reading of the Act could sweep some or all of these transactions into the new financial market regulatory regime. Mr. Gensler indicated that the Commission staff is working to clarify that these transactions, or “products,” are not “swaps.” We respectfully request that the Commission take the same approach to providing uninterrupted regulatory certainty for commodity trade options. These transactions are not, and should not be regulated as, “swaps.”

the Commission the authority -- indeed the direction -- to further define the fundamentally important terms in the Act, including the foundational term “swap.” See Section 712(d) of the Act. The Commission asked for comment on the defined term “swap” in August 2010,<sup>23</sup> and the Commission and its staff have met with countless representatives of the energy industry and other commercial end users of commodities, who have explained the importance of energy and energy-related commodity and derivatives transactions, including commodity options, to their commercial hedging programs.

The Commodity Options NOPR recites that, “[f]rom its adoption, part 32 has included, in section 32.4, an exemption for commodity options used by commercial entities entering into the commodity options transactions solely for purposes related to their business. [fn 65]. The so-called ‘trade option exemption’ has remained virtually unchanged since 1976 and has provided legal certainty for that segment of the commodity options market available to commercial end users.” NOPR at 6102. The trade options exemption in the Commission’s rules traditionally recognized that commodity options entered into by commercial entities have customized terms that are neither easily standardized nor easily “traded” by financial entities or on regulated exchanges. The exemption was appropriate because the Commission achieved no regulatory purpose by interfering with the unique bilateral contract relationships represented by these commercial transactions. By providing the exemption, the Commission acknowledged that not all elements of the commercial commodity “markets” need to be forced into or onto a financial markets trading structure.

There is no indication in the Act or in the legislative history of the Act that Congress intended the Commission to summarily discard the “trade option exemption” which, as the Commodity Options NOPR acknowledges, since 1976 has provided commercial end users of commodities regulatory certainty that they can engage in trade options in connection with their commercial activities without unnecessary regulatory costs and burdens. See NOPR at 6102. If the Commission proposes rules to discard the “trade option exemption,” it should concurrently replace it with a “trade option exemption for nonfinancial commodities” to the defined term “swap.”

We have reviewed Section V of the EEI/EP SA Letter, and we concur with the comments in that Section. EEI and EP SA note that their members are eligible contract participants, and therefore their comments speak from the perspective of counterparties to “non-eligible contract participants” of the harm caused by elimination of the trade option exemption. As described in Section I of this letter, the vast majority of the Coalition’s members may be such “non-eligible contract participants” without the regulatory clarifications requested in the Entity NOPR Comment Letter and described in Section IIA above. We appreciate that our counterparties share our view that the elimination of the trade option exemption would cause a dramatic and

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<sup>23</sup> See the Definitions ANOPR and the comment letter referenced at footnote 2.

unintended disruption to the markets for energy and energy related commodities and commodity-based derivatives.<sup>24</sup>

**C. REGULATION OF TRADE OPTIONS ON NONFINANCIAL COMMODITIES AS “SWAPS” WOULD HAVE DETRIMENTAL CONSEQUENCES FOR NON-FINANCIAL ENTITIES HEDGING COMMERCIAL RISKS AND, FOR NFP ELECTRIC END USERS, WOULD INCREASE THE COST AND PRICE VOLATILITY FOR ELECTRICITY DELIVERED TO RETAIL ELECTRIC CUSTOMERS**

The Commodity Options NOPR states that, “based on its review [of the history of the Commission’s development of commodity options regulation], the Commission has determined that there would be little practical effect and no detrimental consequences in adopting the proposed revisions to the existing commodity options regime in part 32.” See NOPR at page 6101. The Coalition disagrees strongly with the Commission’s determination.

We have reviewed Section IV of the EEI/EPSC Letter, and we concur with the comments in that Section. We respectfully ask that the Commission recognize that, if it chooses to eliminate the “trade option exemption” for commodity options, without replacing it with a substantially similar exemption from the definition of “swap” for options on nonfinancial commodities, the Commission will effectively deny the majority of NFP Electric End Users the ability to cost-effectively manage their commercial risks using commodity options. We consider the Commission’s Proposed Rule to be highly detrimental to the NFP Electric End Users’ ability to provide affordable electric energy to American businesses and consumers.

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<sup>24</sup> The disruption caused by elimination of the trade option exemption will be more significant in the markets for energy and energy-related commodities and commodity-based derivatives than in other markets due to the higher percentage of end-user-to-end-user transactions. See Section IID for more detail on this unique aspect of these markets.



D. THE COMMISSION SHOULD PROPOSE A COMMODITY “TRADE OPTION EXEMPTION” FROM THE DEFINED TERM “SWAP,” AND SUMMARIZE AND RESPOND TO ALL PUBLIC COMMENTS IT HAS RECEIVED ON THIS ISSUE<sup>25</sup>

Whether the Commission deals with the “trade options exemption” in this Commodity Options NOPR, or in its long-anticipated “Products Definition NOPR,” is irrelevant to the NFP Electric End Users. But we reserve our right to comment further on this important issue in that “Product Definition” docket. We respectfully request that the Commission propose language for such an exemption in that docket, and explain how its proposed rules are responsive to the energy industry’s consistent requests for clarification on this important issue. The Commission should not merely again request public comment on whether the trade options exemption is necessary or appropriate in any asset class or for any class of market participant.

As Commission precedent recognizes, trade options are often highly customized to the commercial needs of either the purchaser or the seller of the commodity option. The NFP Electric End Users, and other electric utilities, routinely use energy and energy-related trade options to hedge the constantly-changing weather and load risks that affect their ability to deliver reliable 24/7 electric power to American businesses and consumers.

As described in Section ID (and as we have discussed at length with members of the Commission’s staff), electricity-related goods and services that the Commission may view as “commodities” under the CEA, are of limited quantity, are intrinsically related to the delivery of electricity to the NFP Electric End User’s retail energy customers, and are subject to the regulatory jurisdiction of regulators other than the Commission. For those reasons, they are “commodities,” if at all, that are “nonfinancial” in nature. Moreover, the electric utility’s need for such goods and services is immediate -- electric energy cannot be stored in commercial quantities, and the physics required to maintain voltage support for a stable electric grid requires minute-by-minute synchronization of supply and demand. Electric energy is truly a unique

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<sup>25</sup> In testimony before the House Agriculture Committee on March 31, 2011 (referenced in footnote 22), Chairman Gensler reported that 80 comments were received by the Commission on the Definitions ANOPR in September 2010. A link to our comment letter is provided in footnote 2, and a number of other energy companies and trade associations also commented. Many of those comments encouraged the Commission to confirm the continuing applicability of the commodity “trade option exemption.” Chairman Gensler testified that the Commission staff is working to address the comments on the Definitions ANOPR, and to provide regulatory certainty on such important issues as commodity forwards with embedded options, and commodity forwards that are subsequently “booked out” prior to physical delivery. As Chairman Gensler points out, it is possible to interpret the Act in a manner that is consistent with the Commission’s previous history. We look forward to a Proposed Rule that also provides a commodity “trade option exemption” to the definition of “swap,” a concept consistent with decades of Commission precedent.

“commodity.” Consequently, electric energy-related “commodities” and “commodity options” are also unique, and highly customized, even more than the agricultural “trade options” with which the Commission is more familiar.

For example, transmission capacity on the interconnected electric grid is critical to delivery of electric energy, and yet such transmission capacity is constrained. An NFP Electric End User may have transmission capacity rights (the option but not the obligation to use such transmission capacity to bring electric power to its service territory from outside the region) in greater quantities during its electric load “peak season” than during other times of the year. Transmission capacity rights are defined differently in the various RTO “markets” around the country in which such rights are bought and sold, and the rights in one RTO market are not fungible with the similar rights defined by and transacted in other RTO markets.

As another example, “generation capacity” (the megawatts of generation resources located in a particular geographic region with the ability to produce electricity to maintain the essential “balance” of power inputs to power usage on the grid) is an important concept to maintaining the reliability of the electric grid. To earn revenue on the generation resources they own, generators will enter into “generation capacity” contracts with RTOs or with individual utilities that have “resource adequacy” obligations. The generator agrees to provide generation capacity when and if required to meet the demand for electric power in that geographic region. Because of the utilities’ “resource adequacy” obligations and the RTO’s obligation to maintain grid reliability, and because other entities may own the generation resources that can assist in meeting, or “hedging,” such obligations, there are “markets” in various regions for “generation capacity” products. These products are, in essence, uniquely-structured options that serve as hedges for a utility’s resource adequacy obligation, should the utility be called on to provide generation support to the grid. The generator, in essence, is able to write a customized call option that matches the unique characteristics of a utility’s resource adequacy obligation or an RTO’s need for generation capacity. The generator then sells the option to a utility, or into the applicable RTO market. The RTO or utility holds such call option rights and exercises (or calls) on the generation capacity to meet Federal reliability standards and requirements.

The price of electric power as a commodity delivered in any region of the country, and the price of these energy-related “trade options,” can be highly volatile due again to regional and seasonal weather patterns, constraints in transmission systems, loss of electric energy if it is transmitted over long distances and, again, the fact that electric energy cannot be stored in commercial quantities. For all these reasons, electric utilities are significant “end users” of highly customized over-the-counter energy and energy-related “commodity options,” which are both cost effective and necessary for prudent commercial risk management. The Federal Energy Regulatory Commission, as the primary regulator of the electric utility industry and interstate transactions in electric power, has long encouraged electric utilities to make use of energy and energy-related commodity and derivative transactions (and, in particular, options on electric energy and related nonfinancial commodities) in order to prudently manage the price volatility of

electric power to be delivered to the utility's customers, whose hourly usage patterns fluctuate constantly and widely based on weather conditions and other factors.<sup>26</sup>

We respectfully request that the Commission revise and preserve the "trade option exemption," to allow non-financial entities like the NFP Electric End Users to hedge commercial commodity risks inherent in their enterprises. We respectfully request, and we expect, the Commission to propose language for such an exemption in its long-anticipated "Product Definitions NOPR." We respectfully request as well responses to our comments in the Definitions ANOPR Comment Letter about the importance of commodity (or "trade") options not being subject to regulation under the Act, and to our "footnote 4" comments over the past 7 months.

A trade option exemption to the definition of "swap" is consistent with the Act's exclusion of nonfinancial commodity forward transactions, consistent with Commission precedent and consistent with the legislative intent. Such an interpretation of the Act would be far more appropriate than summarily concluding, as the Commodity Options NOPR seems to conclude, that Congress intended to deny small non-financial entities like the NFP Electric End Users the ability to enter into trade options on nonfinancial commodities to manage the commercial risks of their public service activities.

E. THE COMMISSION'S "INITIAL REGULATORY FLEXIBILITY ACT ANALYSIS" IS FUNDAMENTALLY FLAWED, BASED ON AN UNSUPPORTED ASSUMPTION THAT ELIGIBLE CONTRACT PARTICIPANTS ARE NOT SMALL ENTITIES AND A MISINTERPRETATION OF THE DEFINED TERM "SMALL ENTITY"

In our comment letters on the Commission's rulemaking under the Act to date, the Coalition has reserved the right to contest the Commission's cost benefit analysis of the initial

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<sup>26</sup> For more information about the unique types of transactions (some with option-like characteristics) that occur in connection with the delivery of electricity as a "commodity," please see the following web links:

<http://www.epsa.org/industry/primer/>

<http://www.eei.org/whoweare/AboutIndustry/Pages/History.aspx>

[http://www.oe.energy.gov/information\\_center/electricity101.htm](http://www.oe.energy.gov/information_center/electricity101.htm)

<http://www.nerc.com/page.php?cid=1|15>

<http://ferc.gov/about/taxonomy.asp>

rulemakings under the Act taken as a whole. The Coalition has generally, but not specifically, challenged the Commission's Regulatory Flexibility Act "analysis" of the burdens imposed by the rules on "small entities." See Section IV below, where we similarly reserve rights. We have taken this position because the Commission's cost estimates have thus far been unsupported and wholly unrealistic from the perspective of a non-financial entity without the systems or staff to interpret and assess the registration, recordkeeping and reporting obligations of the Commission's Proposed Rules. Moreover, in each NOPR, the Commission has asserted oddly precise estimates about the number of swaps, market participants, annual transactions, estimated costs and other facts attributable to each separate set of Proposed Rules, in assessing potential regulatory effects on diverse swaps markets and diverse market participants about which the Commission has admitted that it has no data and with which it has no experience. The Commission's assumptions and estimates have not been substantiated with facts or research in respect of the energy markets, and are particularly incomprehensible to the NFP Electric End Users in that the Commission has yet to provide guidance on the scope of Energy Commodity Swaps (or any category, class or type of "swaps") that will be subject to its new regulatory regime.<sup>27</sup>

However, the Proposed Rules in the Commodity Options NOPR, even if evaluated separately from the remainder of the Commission's rulemakings under the Act, would have such a substantial adverse impact on the NFP Electric End Users that we are compelled to point out a few of the fundamental flaws in the Commission's "initial Regulatory Flexibility Act analysis."<sup>28</sup> If the Commission chooses not to respond to our request to include a replacement "trade option exemption" for nonfinancial commodities in its further definition of "swap," the NFP Electric End Users expect to promptly ask the Office of Management and Budget to open a full inquiry into this rulemaking, in addition to pursuing all other available remedies.

In the Commodity Options NOPR, the Commission purports to provide an "initial Regulatory Flexibility Act analysis" that has, at its core, two analytic flaws. First, the Commodity Options NOPR states that the Commission has previously determined that "eligible contract participants" are not "small entities" for purposes of the RFA. This statement is wrong. The citation provided in the Commodity Options NOPR does not provide either legal support, or even helpful regulatory analysis, to underpin this conclusory misstatement of the law. The cited reference is to a comment made in passing by the Commission in an April 2001 rule on "Opting Out of Segregation." The "Opting Out" rule set forth the circumstances under which a CFTC-regulated futures commission merchant (an "FCM") could allow an "eligible contract participant" (a newly-defined category of FCM customer under the CEA) an "opt out right" that was not otherwise available to the FCM's non-eligible contract participant customers. The rule did not include an analysis under 5 U.S.C. §603 of what a "small entity" was or was not.

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<sup>27</sup> See footnote 4.

<sup>28</sup> The Regulatory Flexibility Act ("RFA") requires the Commission to prepare an initial regulatory flexibility analysis whenever it publishes a proposed rule. 5 U.S.C. §603.

Instead, the cited reference simply asserted that “eligible contract participants, as defined in the [then] newly-amended Act, by the nature of the definition, *should not* be considered small entities (emphasis added).”<sup>29</sup> The Commission then went on to justify its “Opting Out” rule by noting that the opt-out decision was at the discretion of the eligible contract participant anyway, rather than an option that could to be imposed on the customer by the FCM. Hence the Commission found that the “Opting Out” rule could not be seen to burden the customer. Nowhere in the “Opting Out” rule did the Commission determine that “eligible contract participants” are not, and cannot be, “small entities” for RFA purposes. Indeed, it is not clear why the Commission would have the jurisdiction to decide whether an entity, or a type of entity, meets the requirements for a “small entity” under the RFA.<sup>30</sup>

Second, the Commodity Options NOPR’s “initial RFA analysis” then goes on to describe the small entities that would be affected by elimination of the trade option exemption as those entities that are “smaller” than an eligible contract participant, in that the entities have annual receipts less than \$750,000. The Commodity Options NOPR cites this financial test as the threshold for the definition of “small entity” in the RFA.<sup>31</sup> The NFP Electric End Users respectfully disagree with this aspect of the Commission’s RFA analysis for two reasons.

The financial hurdles in the CEA definition of eligible contract participant relate to net worth and assets -- essentially balance sheet tests of financial strength. The RFA financial test cited by the Commodity Options NOPR is an unrelated test of annual receipts -- an income statement test that is wholly unrelated to the two balance sheet tests in the definition of eligible contract participant. An entity with less than \$750,000 in annual receipts may nonetheless be an eligible contract participant for CEA purposes, and an entity that has more than \$750,000 in annual receipts may still not meet the financial hurdles for the CEA’s eligible contract participant

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<sup>29</sup> 66 Fed. Reg. 20743, April 25, 2001.

<sup>30</sup> At the time the “Opting Out” rule was adopted by the Commission in April 2001, the “eligible contract participant” designation was of much less value to a “small entity” than it will be under the CEA, as amended by the Act. As discussed earlier, under the pre-Act CEA, a “small entity” could still enter into “trade options,” could still enter into “swaps” if it met the criteria under the “eligible swap participant” exemption under Part 35, and could still enter into bilateral commodity-based derivatives transactions if it used the commodity in the normal course of its business and believed in good faith that it was an “eligible commercial entity.” The Act has changed all that. Now there will be many, many more small entities that need the trade option exemption for their commercial commodity hedges. “Small entities” will need the “eligible contract participant” designation to execute “swaps” other than on a designated contract market. The Commission cannot simply rely on its own passing comment in the “Opting Out” rule as if it were legal precedent for the conclusion that eligible contract participants, as a class, are not small entities under the RFA (and under the Small Business Act, see below).

<sup>31</sup> 76 Fed. Reg. 6107, February 3, 2011.

definition. The two definitions use independent and different measures of financial strength and performance.

Moreover, although an RFA analysis may use a test with the referenced \$750,000 annual receipts threshold to determine the number of “small entities” that would be affected by the Proposed Rules, this financial test applies only to measuring whether an agricultural enterprise meets the “small entity” test, not to measuring whether any type of enterprise meets the definition of “small entity.”<sup>32</sup> To analyze the number of “small entities” in another type of commodity or commodity-based derivatives market, the RFA analysis will use a different “small entity” test.

The RFA refers to the Small Business Act for the definition of small entity. The Small Business Act provides that the Small Business Administrator may specify detailed standards, using appropriate factors, for determining a small business concern.<sup>33</sup> In accordance with the Small Business Act, the Small Business Administration has established a table of small business size standards matched to the North American Industry Classification System (“NAICS”) and published the table on its website.<sup>34</sup>

As the Coalition has noted in Section I, and in Section I of virtually all of its comment letters filed to date in the Commission’s rulemakings under the Act, for electric utilities “[a] firm is small if, including its affiliates, it is primarily engaged in the generation, transmission, and/or distribution of electric energy for sale and its total electric output for the preceding fiscal year did not exceed 4 million megawatt hours.”<sup>35</sup> The indication of a small entity for RFA purposes for an electric utility has nothing to do with the entity’s annual receipts. As more completely described in Section I, there are approximately 2,800 NFP Electric End Users that are small entities under the applicable definition for purposes of the RFA.

The NFP Electric End Users request that the Commission undertake a full and careful analysis under the RFA of the potential impact on “small entities” of both the Proposed Rules in the Commodity Options NOPR, and of its initial rules implementing the Act taken as a whole

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<sup>32</sup> 15 U.S.C. §632(a)(1)

<sup>33</sup> 15 U.S.C. §632(a)(2)

<sup>34</sup> Small Business Administration size standards web site:

<http://www.sba.gov/category/navigation-structure/contracting/contracting-officials/size-standards>

<sup>35</sup> U.S. Small Business Administration, “Table of Small Business Size Standards Matched to North American Industry Classification System Codes,” footnote 1, available at: [http://www.sba.gov/sites/default/files/Size\\_Standards\\_Table.pdf](http://www.sba.gov/sites/default/files/Size_Standards_Table.pdf).

(see Section IV). The Commission should revise its analysis to eliminate its unsupported assumption that eligible contract participants are not small entities, and to calculate the number of “small entities” participating in the various commodity and commodity-based derivatives markets using the appropriate financial measures for purposes of the RFA.

**III. ALL COMMENT PERIODS SHOULD REMAIN OPEN UNTIL ALL THE BASIC RULES UNDER TITLE VII OF THE ACT HAVE BEEN PROMULGATED. THEREAFTER, ONCE THE RULES ARE FINALIZED, THE COMMISSION SHOULD PROVIDE EXTENDED TRANSITION PERIODS TAILORED TO THE NEEDS OF NON-FINANCIAL ENTITIES IN THE DIVERSE MARKETS FOR DIFFERENT CATEGORIES, CLASSES AND TYPES OF SWAPS (AND FORWARDS AND OPTIONS ON NONFINANCIAL COMMODITIES) USED AS COMMERCIAL RISK MANAGEMENT TOOLS**

The Coalition urges the Commission to hold open the comment periods on all initial rules being promulgated under the Act, to enable various industries such as the energy industry, and various types of market participants in the diverse markets for swaps, to consider the regulations and the corresponding definitions as a whole. The rules are complex and interconnected, and create a new market structure within which non-financial entities will need to conduct their commercial enterprises and hedge their commercial risks. The Coalition appreciates the Chairman’s recent statement that the Commission has established a “31st rulemaking team” (in addition to the 30 task forces originally established by the Commission to draft rules under the Act), whose sole task is to review the regulations under the CEA as a whole, in light of the changes to the CEA made by the Act.<sup>36</sup> We look forward to working with this new team to provide the perspective of the non-financial entity -- a type of entity over which the Commission, prior to the Act, did not have jurisdiction in many respects. In reviewing the existing regulations, as well as in the current rulemakings, we encourage the Commission to assure that its rules, taken as a whole, are clear, consistent and understandable to entities like the NFP Electric End Users. We also urge this new rulemaking team to be sure that the new regulatory regime does not eliminate exemptions and precedent that has worked well to protect and preserve the rights of non-financial entities to hedge their commercial risks, by assuming that Congress intended the Commission to radically change the way in which commercial transactions involving “commodities” are regulated.

Once complete, the new market structure will need to be integrated with the existing regulatory structures within which the energy companies conduct their commercial enterprises. The NFP Electric End Users look forward to the memoranda of understanding between the Commission and FERC that are intended by Congress to avoid regulatory inconsistencies and overlap, and to provide regulatory certainty to the providers of essential commodities and

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<sup>36</sup> Testimony of Chairman Gary Gensler before the House Committee on Agriculture, February 10, 2011, available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-68.html>.

services to the American public. Once the rules under the Act are finalized and the interplay with the FERC rules and jurisdiction made consistent, the NFP Electric End Users will need substantial time to analyze their operations and install new systems, staffing and operating procedures and protocols to adapt to the new market structure, while continuing to seamlessly deliver reliable and affordable electricity to American consumers and businesses and comply with their existing regulatory and corporate recordkeeping and reporting requirements. We urge the Commission to allow time for comprehensive review of the new market structure prior to making the complex new rules effective with respect to energy and energy-related transactions, and to allow transition times that are adequate for non-financial entities like the NFP Electric End Users to adapt their commercial enterprises to the new market structure and regulatory protocols.<sup>37</sup>

#### **IV. THE COMMISSION MUST CONSIDER THE OVERALL IMPACT OF ITS RULES PROMULGATED UNDER THE ACT ON SMALL ENTITIES**

Section IIE above addresses the Commission's "initial RFA analysis" in the Commodity Options NOPR. Section IV addresses the need for such an analysis to be conducted in respect of the Commission's initial rulemakings under the Act taken as a whole.

The Commission cannot assume the overarching regulatory benefit of its Proposed Rules, while ignoring the regulatory costs of those same Proposed Rules that it will be imposing on non-financial entities, for markets about which the Commission acknowledges it has insufficient information. In response to the Commission's invitation at pages 6105 through 6107 of the Commodity Options NOPR, the Coalition will provide a copy of this comment letter to the Office of Information and Regulatory Affairs at [OIRA-submissions@omb.eop.gov](mailto:OIRA-submissions@omb.eop.gov).

As discussed in Section I above, the Coalition's members include many "small entities" as that term is defined in the Regulatory Flexibility Act. 5 U.S.C. §§ 601-612 (as amended Mar. 29, 1996 by the Small Business Regulatory Enforcement Fairness Act). 13 C.F.R. §121.201, n.1. Each of the complex and interrelated regulations currently being proposed by the Commission has both an individual, and a cumulative, affect on such small entities. Whether a particular proposed regulation is required by the Act, or is proposed pursuant to the Commission's "interpretation" of the Act (such as the Real-Time Data NOPR), is proposed pursuant to "implicit" authority or "to provide guidance and clarity" for the Commission's jurisdiction under the Act (see the Second Interim Final Rule, 75 Fed. Reg. 78,892, issued December 17, 2010, at 75,893), or the Commission just views as "removing unnecessary

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<sup>37</sup> We recommend that longer transition periods be allowed for those non-financial entities, like the NFP Electric End Users, that use customized forward transactions and options on nonfinancial energy and energy-related commodities, and expect to elect the end-user exception for all of their "swaps" and the bona fide hedging exemption for all of their "referenced contracts" under the Commission's new rules, and that have no independent resources from which to pay the cost of the new regulatory market structure.



provisions” in light of the Act (see Commodity Options NOPR at 6098), the Commission rulemakings under the Act constitute an accumulation of interrelated regulatory burdens and costs on non-financial small entities like the NFP Electric End Users. The NFP Electric End Users, as small entities, who seek to transact in Energy Commodity Swaps and “referenced contracts” only to hedge the commercial risks of their not-for-profit public service activities. The NFP Electric End Users reserve their rights as small entities to assess the full impact of the initial rulemakings being promulgated by the Commission under the Act, and to require a SBREFA analysis be conducted with respect to those regulations as a whole.

In each of its ongoing rulemakings, the Commission acknowledges that it has no experience under the new requirements of the Act in regulating the swaps markets or non-financial entity market participants such as the NFP Electric End Users. Each Proposed Rule addresses a different piece of the Commission’s overall rulemaking challenge under the Act. The Commission’s cost-benefit analysis in each NOPR includes assumptions about the number of non-cleared “swaps,” the number of “swap dealers” and major swap participants,” the number of “financial entities,” the number of annual transactions, the number of end-user-to-end-user transactions, the number of calculations, valuations and disclosures, and what information the Commission needs about the non-cleared swaps markets or each non-cleared swap transaction or each market participant. The NFP Electric End Users reserve the right to dispute all these assumptions, and request that the Commission fulfill its statutory requirements under SBREFA to provide economic data showing that the aggregate costs and cumulative regulatory burdens imposed on such small entities by the initial rulemakings to implement the Act are necessary, and that there are no alternatives to achieving the regulatory goals that would impose fewer burdens and less costs on the NFP Electric End Users and energy consumers.

## V. CONCLUSION

The Coalition encourages the Commission to consider the perspective of non-financial entities using derivatives to hedge commercial risk at every step of its regulatory rulemaking process under the Act, and to ask whether its rules are clear to those who are not regular participants in the financial markets. We respectfully request that, as the Commission drafts its rules, it carefully consider the questions of and consequences to those who operate commercial enterprises and are drawn into this new regulatory environment only because of the Act’s broad statutory language could be interpreted to redefine traditional commercial contracts as “commodities” or as “swaps.”<sup>38</sup> And we respectfully request that only the minimum, necessary regulatory burdens and costs be applied to non-financial entities participating in the markets as “end users” or “bona fide hedgers” hedging commercial risk. Each new direct or indirect cost or regulatory recordkeeping or reporting requirements will result, dollar for dollar, in higher costs to the NFP Electric End Users’ customers and owners -- approximately 87 million consumers of electric energy.

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<sup>38</sup> See footnote 4.

David Stawick, Secretary

April 4, 2011

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We stand ready to help the Commission understand our organizations and affiliates, our industry and our markets, our transactions and documentation, and how our not-for-profit members use Energy Commodity Swaps to hedge the commercial risks inherent in their public service activities. Please contact any of the Coalition's representatives for information or assistance.

David Stawick, Secretary  
April 4, 2011  
Signature Page

**COMMODITY OPTIONS AND  
AGRICULTURAL SWAPS**

Respectfully yours,

**THE "NOT-FOR-PROFIT ELECTRIC END USER  
COALITION":**

**NATIONAL RURAL ELECTRIC  
COOPERATIVE ASSOCIATION**

By: Russ Wasson  
Russell Wasson  
Director, Tax, Finance and Accounting  
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**AMERICAN PUBLIC POWER ASSOCIATION**

By: \_\_\_\_\_  
Susan N. Kelly  
Senior Vice President of Policy Analysis  
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**LARGE PUBLIC POWER COUNCIL**

By: \_\_\_\_\_  
Noreen Roche-Carter  
Chair, Tax and Finance Task Force

cc: Honorable Gary Gensler, Chairman  
Honorable Michael Dunn, Commissioner  
Honorable Jill E. Sommers, Commissioner  
Honorable Bart Chilton, Commissioner  
Honorable Scott O'Malia, Commissioner

David Stawick, Secretary  
April 4, 2011  
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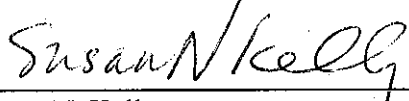
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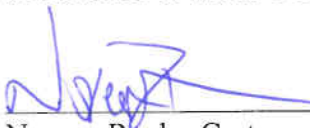
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